**MERIT PROPERTIES SDN BHD**

**v.**

**AKTIF LIFESTYLE STORES SDN BHD & ANOR**

COURT OF APPEAL, PUTRAJAYA
DENIS ONG JCA
RICHARD MALANJUM JCA
AZMEL MAAMOR JCA
[CIVIL APPEAL NO: W-02-824-1999]
31 MAY 2007

***BANKING:*** *Securities - Guarantee - Whether guarantee conditional or unconditional - Whether guarantee on-demand*

***LANDLORD AND TENANT:*** *Lease - Agreement - Guarantees furnished as security - Whether conditional or unconditional - Whether on-demand*

In this appeal which concerned a lease agreement between the parties herein, the main issue was whether the appellant/lessee had a right to call upon two bank guarantees issued by the 2nd respondent/bank as security upon termination of the lease by the 1st respondent/lessor.

**Held (allowing the appeal in respect of 1st guarantee only)**
**Per Richard Malanjum JCA delivering the judgment of the court:**

**(1)** The wordings in the said guarantees were self-evident of on-demand guarantees. The 2nd respondent must honour the "on demand" guarantees irrespective of the dispute between the 1st respondent and the appellant and/or the continued existence of the lease agreement. Otherwise the commercial intent, character and use of such guarantees would be irreparably prejudiced. The only exception was if fraud was involved and there was no such allegation herein. (paras 22 & 26)

**(2)** The demand was triggered by the unilateral termination of the lease by the 1st respondent that caused the appellant to exercise its rights to demand the performance of the said guarantees. However, the facts showed that only the 1st guarantee was valid at the material time since the 2nd guarantee had already expired by then. (paras 27 & 28)

A ***Bahasa Malaysia*** *translation of headnotes*

Dalam rayuan ini, yang menyangkuti perjanjian pajakan di antara pihak-pihak di sini, isu utama yang berbangkit adalah sama ada perayu/penerima pajak berhak untuk bergantung kepada dua
B gerenti bank yang diberikan oleh responden kedua/bank sebagai jaminan sebaik pajakan ditamatkan oleh responden pertama/pemberi pajak.

**Diputuskan (membenarkan rayuan berhubung gerenti pertama sahaja)**
C **Oleh Richard Malanjum HMR menyampaikan penghakiman mahkamah:**

**(1)** Perkataan-perkataan di dalam gerenti-gerenti jelas menjurus kepada gerenti atas tuntutan. Responden kedua harus
D menunaikan gerenti-gerenti "atas tuntutan" tersebut tanpa mengira pertikaian antara responden pertama dan perayu dan/ atau kewujudan yang berterusan pajakan. Jika tidak, niat komersial, sifat dan kegunaan gerenti-gerenti akan terjejas. Satu-satunya pengecualian adalah jika ia melibatkan fraud tetapi
E tiada alegasi fraud dibuat di sini.

**(2)** Tuntutan dicetuskan oleh penamatan sebelah pihak pajakan oleh responden pertama yang menyebabkan perayu melaksanakan haknya untuk menuntut pelaksanaan perjanjian
F pajakan. Apapun, fakta menunjukkan bahawa hanya gerenti pertama masih sah pada waktu material kerana gerenti kedua sudah pun luput pada ketika itu.

**Case(s) referred to:**
G *China Airlines Ltd v. Maltran Air Corp Sdn Bhd [1996] 3 CLJ 163 FC* ***(refd)***

*Esso Petroleum Malaysia Inc v. Kago Petroleum Sdn Bhd [1995] 1 CLJ 283 SC* ***(refd)***

*Government of Malaysia v. South East Asia Insurance Bhd [2000] 3 CLJ 705 FC* ***(refd)***

H *For the appellant - CS Kumar; M/s Sri Ram & Co*

*For the 1st respondent - Dennis Appaduray (Wong Rhen Yen with him); M/s Dennis Nik & Wong*

*For the 2nd respondent - Uma Devi (SH Teh with her); M/s Teh & Azlina*

I *[Appeal from High Court, Kuala Lumpur; Originating Summons No: D7-24-90-1999]*

*Reported by Usha Thiagarajah*

## JUDGMENT

**Richard Malanjum JCA:**

### Introduction

**[1]** This is an appeal from the appellant dissatisfied with the High Court decision allowing with costs the 1st respondent's application *vide* the originating summons dated 15 March 1999 for declaratory relief and injunction.

**[2]** The 1st respondent's application before the High Court was, *inter alia*, for declarations that the appellant does not have the right or power to call upon bank guarantees No. 70068701146 as "fit out deposit" for RM190,096 ("the 1st guarantee) and No. 70068701153 for RM570,290.70 as "rental deposit" ("the 2nd guarantee"), both (collectively referred to as "the said guarantees"), both issued by the 2nd respondent in favour of the appellant and injunctions against the appellant and the 2nd respondent restraining the 2nd respondent from making any payment under the said guarantees.

### Brief Facts Of Case

**[3]** On 24 February 1997, the 1st respondent as the Lessee and the appellant as the lessor entered into a lease agreement in respect of part of a property known as Johor Bharu City Square ("the lease agreement") over part of a shopping centre known as City Square in Johor Bahru commencing from 1 December 1998.

**[4]** Clauses 3.1(a) and (b) of the lease agreement required the 1st respondent to furnish the said guarantees as security for the due observance and performance by the 1st respondent of the covenants and conditions in the lease agreement, and by way of payment of the rental deposit.

**[5]** In compliance with the lease agreement and upon the request of the 1st respondent, on 23 April 1997, the 2nd respondent issued the said guarantees to the appellant.

**[6]** The said guarantees had similar wordings save and except cl. 5 of the 1st guarantee was subsequently amended by the 2nd respondent's letter dated 5 October 1998 to the appellant. Initially, the effective date of the 1st guarantee was from 24

February 1997 to 1 September 1998 and remained in force until receipt of payment in cash by the 1st respondent on the commencement Lease, ie, 1 December 1998.

**[7]** On 26 August 1998, the appellant issued a demand on the 1st guarantee. However, on 2 September 1998, the respondent refused to pay, stating that the appellant's demand was premature as the commencement date of the lease was not due then, which was 1 December 1998.

**[8]** On 25 September 1998, the 1st respondent requested an extension of the 1st guarantee for six months till 3 March 1999, all other terms remained unchanged.

**[9]** The 2nd respondent by a letter dated 5 October 1998 to the appellant and without prior consent of the 1st respondent, unilaterally amended cl. 5 of the 1st guarantee by replacing the word "commencement date" with the words "commencement of fit out period as evidenced by written notice of commencement of fit out." The 2nd respondent informed the appellant that the 1st guarantee had at the request of the 1st respondent been extended to 3 March 1999 and certain amendments were made to cl. 5 of the 1st guarantee in conformity with the original format furnished by the appellant.

**[10]** Thereafter by a letter dated 5 December 1998, the appellant wrote to the 2nd respondent instructing the 2nd respondent to extend the 2nd guarantee to 1 April 1999. The 2nd respondent never confirmed this. However by a letter dated 28 January 1999, the 1st respondent wrote to the 2nd respondent confirming that the 2nd guarantee would be renewed subject to a revision of rental which had been agreed upon.

**At The High Court**

**[11]** After considering the submissions of learned counsel for both parties and the clauses of the lease agreement and the said guarantees, the learned High Court judge ruled that the said guarantees were absolute, unconditional and irrevocable during their term, but cl. 4 of the said guarantees made them conditional in that the lessor had the right to call upon the bank to release the sums in the said guarantees only "if the lessee shall make default in the performance or observance of any of the terms and/

or provisions contained in the said lease". The manner in which the said guarantees were framed did not intend to provide for a situation where there would be no commencement of the fit-out period and consequentially the said lease would not commence.

**[12]** Accordingly the learned High Court Judge allowed the 1st respondent's application ie, a declaration that the appellant or its agent did not have the right or power to make any call or claim upon 1st and 2nd bank guarantees issued by the 2nd respondent, and consequently an injunction was thus granted restraining the bank from making payment under the said guarantees.

## Before The Court Of Appeal

**[13]** At the conclusion of the appeal to the Court of Appeal, we allowed the appeal in part in respect of the 1st guarantee only ie, declaration against the appellant is set aside and the injunction against 2nd respondent is also set aside. In respect of the 2nd guarantee, the orders made by the High Court against respective parties are affirmed. There is now a pending appeal to the Federal Court. We now give our grounds of judgment.

**[14]** The main issue for determination by this court is whether the said guarantees are conditional or unconditional. It is a matter of construction. If the said guarantees are ruled to be unconditional, it would give the appellant the right to call upon the said guarantees and the 2nd respondent would have to make payments on the 1st and 2nd guarantees pursuant to the demand made by the appellant.

**[15]** The appellant submitted that the said guarantees were unconditional since they were issued "on demand". The appellant further submitted that the learned High Court Judge had erred in finding that the subsequent wording of the guarantees made them conditional. The 2nd respondent supported such contention of the appellant but could not make any payment due to the injunction issued by the High Court. The 2nd respondent was willing to pay only for the 1st guarantee but not the 2nd guarantee as it had lapsed.

**[16]** However, the 1st respondent submitted otherwise contending that demand on the said guarantees could only be made upon a breach of the condition therein.

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## Findings Of This Court

### The 1st Guarantee

**[17]** The said guarantees were intended to secure performance of the lease. The 1st guarantee was valid from 24 February 1997 to 3 March 1999 and remained in force until the lessee paid to the lessor the sum of RM190,096.90 on the commencement of the fit out period. In an event of early termination, prior to the commencement date of the lease, the lessor would be entitled to forfeit all deposits paid by the lessee. This is clearly specified in the cl. 7.9 of the lease agreement which reads:

> 7.9 UNILATERAL DETERMINATION OF LEASE
>
> (i) In the event of the Lessee terminating the Lease prior to the commencement Date of the Lease, the Lessor shall be entitled to forfeit all deposits paid by the Lessee to the Lessor pursuant to Article III without prejudice to any right of action of the Lessor against the Lessee for any other loss or damages suffered or sustained by the Lessor.

**[18]** We are unable to agree with the finding of learned High Court Judge that the said guarantees are conditional *vide* cl. 4 of the said guarantees. The learned High Court Judge erred when he considered extraneous material on the said guarantees. *Vide* letter dated 5 December 1998, the appellant had written to the 2nd respondent of its intention to extend the 2nd guarantee until 1 April 1999. Unfortunately, this was never agreed nor confirmed by the 2nd respondent. However, the 1st respondent *vide* a letter dated 28 January 1999, sent a letter to the 2nd respondent confirming that the 2nd guarantee would be renewed subject to a revision of rental which had been agreed upon. *Vide* letter dated 1 March 1999 exh. "CLY8", the 1st respondent wrote to the appellant terminating the lease on the ground the appellant had breached the terms therein. In other words, there was no extension of the 2nd guarantee thereby rendering it to be bad and thus lapsed. Indeed the 1st respondent had unilaterally terminated the lease on 1 March 1999 and such fact was not in dispute. Termination of the lease came earlier than the commencement date of 1 April 1999.

B C D E F G H I

**Whether The 1st Guarantee Was Unconditional**

**[19]** The 1st guarantee was "on demand", thus independent of the lease agreement. All that is required to trigger payment is a demand in writing.

**[20]** In dealing with the interpretation of the words "conditional" and "unconditional", Mohamed Dzaiddin FCJ (as he then was) in *Government of Malaysia v. South East Asia Insurance Bhd* [2003] 3 CLJ 705; referred to *China Airlines Ltd v. Maltran Air Corp Sdn Bhd* [1996] 3 CLJ 163 which affirmed that there are two types of bond. The first is a conditional bond whereby a guarantor becomes liable upon proof of a breach of the terms of the principal contract by the principal and the beneficiary sustaining loss as a result of such breach. The guarantor's liability will therefore arise as a result of the principal's default. The second is an unconditional or 'on demand' bond where a guarantor beneficiary need not prove any default in performance of the principal contract.

**[21]** In *Esso Petroleum Malaysia Inc v. Kago Petroleum Sdn Bhd* [1995] 1 CLJ 283, the then Supreme Court ruled 'the performance bond was, on a true construction, a pure "on demand" guarantee, and all that was required to trigger them was a demand in writing. It would not be dependent or conditional on the production of the document, eg, a certificate from some nominated independent person like an architect as in some building contracts, etc. Neither was it worded to make it conditional for Bank Bumiputra, the issuer of the performance bond, to inquire into the existence or otherwise of any breach of any contractual obligation between the beneficiary of the bond, ie, the buyer in this case, and the seller; at the behest of the latter itself, the performance bond was issued. It was not even worded to make it conditional on a simple declaration by the beneficiary, without proof to its issuer, that the seller had not paid damages to the buyer after the release by the buyer of the sum of RM466,562. In fact, the present performance bond, had it been worded, eg to require any proof of breach by the buyer so as to deserve any payment, then, in such event, its commercial acceptability as a performance bond, would be mostly lost.

Dealing further with the construction of the performance bond, since we found it was on demand performance bond, this would, in our view, make the present performance bonds independent of any underlying contract, ie, any contract between the buyer and the seller. We thought, therefore, it was not open to His Lordship in the court below to impart into this on demand guarantee, by implication, a requirement to have regard to, or to inquire into any breach of any obligation of such underlying contract, and this seemed to have been done. *The next and only other question from the instant performance bonds would be as to what sort of demand it would be as required by its wording*." (emphasis added)

**[22]** Premised on the foregoing principle formulated by the above case, it is necessary to peruse the relevant parts of the said guarantees. The issue in the present appeal is whether the said guarantees are conditional or 'on demand' guarantee. The manner the said guarantees were worded so as to be self-evident.

**[23]** Clause 3 states "… irrevocably and unconditionally … upon first demand … undertake to make payments."

**[24]** Clause 4 state "… the lessor shall have the right to call upon the bank by notice in writing to release the total sum due and owing … and it shall not be necessary or required in order to maintain and enforce the bank's liability … *that the demand shall be made on the lessee … and the bank shall be under no obligation to determine the nature of the breach nor the amount owing under the said lease and shall accept as correct with regard thereto …*" (emphasis added)

**[25]** Again the word "unconditionally" is found in cl. 6(a) and (b) of the said guarantees thereby providing the burden imposed on the 2nd respondent which "… shall be absolute and unconditional irrespective of any change or waiver or departure from the terms of the said lease or any other circumstance which might otherwise constitute a defence available to, or a discharge of, the lessee in respect with its obligations or the bank's obligation under this guarantee ... shall not be revocable … and shall not be discharged by … or any other disability or impediment against enforcement of liability of the lessee which shall nowise impair or effect the bank's liability and obligation hereunder."

**[26]** The 2nd respondent must honour the "on demand" guarantees irrespective of the dispute between the 1st respondent and the appellant and/or the continued existence of the lease agreement. Otherwise, the commercial intent, character and use of such guarantees would be irreparably prejudiced. The only exception is when fraud is involved. There is no allegation of fraud here.

**What Triggered The Demand?**

**[27]** The obvious answer to the question posed is the unilateral termination of the lease by the 1st respondent which caused the appellant to exercise its rights to demand the performance of the said guarantees as contained in exh. "CLY9".

**Second Guarantee**

**[28]** The issue is whether the 2nd guarantee takes the same position as the 1st guarantee. Clause 5 of the 2nd guarantee states that the 2nd guarantee is effective from 24 February 1998 to 1 December 1998 and shall remain in force until receipt of payment in cash by the 1st respondent on the commencement date of the said lease. The commencement date as construed under s. 2 of the 2nd Schedule of the lease agreement means "the date of the commencement of the lease set out in s. 2 of the 2nd Schedule (ie, 1 December 1998) or such other date as may be reasonably determined by the lessor. The 2nd guarantee was no longer valid since it expired on 1 December 1998 and was not extended. Immediately after the lease agreement was terminated it entails the guarantees as non realizable.

**Conclusion**

**[29]** For the above reasons we allow the appeal in part in respect of the 1st guarantee only ie, declaration against the appellant is set aside and the injunction against 2nd respondent is also set aside. In respect of the 2nd guarantee, the orders made by the High Court against respective parties are affirmed. Costs to appellant to be taxed here and below and deposit paid to be refunded to appellant.